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SUBJECT: SCENESETTER FOR CAPSTONE COURSE

#### Summary -----

¶1. (SBU) The Embassy looks forward to your visit to Santiago, which comes as Chile's presidential campaign begins to heat up. President Michelle Bachelet -- who is currently enjoying the highest approval ratings of her presidency -- is constitutionally precluded from seeking a second term. The election, scheduled for December 2009, will likely be a tight race between former President Eduardo Frei and businessman and former Senator Sebastian Pinera. Economically, Chile is feeling the effects of the global financial crisis, although the country is entering this difficult period with strong economic fundamentals and sound policies. Chile faces an energy crisis which has slowed economic growth but spurred significant U.S.-Chile collaboration on energy policies. End Summary.

#### Concertacion: Still in Power after 18 years -----

¶2. (U) Chile's center-left coalition government, the "Concertacion," has been in power continuously since the end of Pinochet's military dictatorship in 1990. The election of current President Michelle Bachelet in January 2006 was heralded as historic. Bachelet is Chile's first female president, a single mother and agnostic in a country with strong, conservative Catholic roots, and a survivor of torture during the Pinochet regime. Bachelet's tenure has included some difficult episodes including student strikes in June 2006 and problems associated with the 2007 initiation of a new public transportation system (Transantiago) in the capital. However, the President -- whose charisma and compelling history have won her widespread personal affection -- has won high marks for her handling of the financial crisis and international affairs. An April 2009 poll gives Bachelet an approval rating of 62 percent -- her best performance yet.

#### Chile on the International Stage -----

¶3. (SBU) Despite some early domestic political missteps, Bachelet performs well on the international stage and has contributed to Chile's rising international stature. In September 2008, she convened a summit of UNASUR, the nascent South American political union, which helped to diffuse, at least temporarily, a crisis in Bolivia and prevented the meeting from degenerating into an anti-American forum. More recently, she hosted left-leaning world leaders, including Vice President Biden, for the Progressive Governance Leaders Summit in Vina del Mar in March. Chile serves as UNASUR's president pro tempore, has a large group of Latin American peacekeepers in Haiti, and is generally active, if behind the

scenes, in regional multilateral fora. Chile and the U.S. see eye-to-eye on many regional and international issues, but Bachelet has made it clear that Chile does not blindly follow where the U.S. leads. In comments during the 2008 UN General Assembly, Bachelet said that the U.S. and Chile were "political friends" and criticized the U.S. for its role in precipitating the financial crisis. She has repeated the latter charge in other public fora as well.

¶4. (SBU) There are some tensions between Chile and its neighbors Peru and Bolivia over territorial disputes stemming from the 19th century War of the Pacific. In January 2008, Peru submitted a case to the International Court of Justice in The Hague asking for a decision on a new maritime border with Chile. For its part, Bolivia would like to regain direct access to the sea -- a request Fidel Castro publically backed during Bachelet's February 2008 trip to Cuba. Nonetheless, all parties are committed to a peaceful resolution of these issues and Chile has said that it is committed to strengthening relations with both countries. Relations between Chile and Venezuela are often frosty, with Chileans objecting to Chavez's grandstanding and arrogance.

#### All Eyes on the Presidential Race

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¶5. (U) Presidential elections are scheduled for December 2009. President Bachelet is constitutionally precluded from seeking an immediate second term. Sebastian Pinera of the opposition National Renewal party will represent the Alianza Coalition. Many analysts cited "Concertacion fatigue" -- exacerbated by four cabinet reshuffles, an energy crisis, the whiff of corruption in several ministries, and increasing concerns over the disenchanted indigenous Mapuche minority -- as the principle reasons behind Pinera's early lead in the polls. However, the race has tightened significantly since Eduardo Frei, former Chilean President (1994-2000) and current Senator, emerged as the Concertacion candidate. This is thought to be due in part to increased levels of confidence in the current Concertacion administration's handling of the economic crisis.

#### General Economic Backdrop

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¶6. (U) Chile's free market economy, development model, and strong institutions have set an example for other countries in the region. Although the global financial crisis has impacted the country, solid economic fundamentals are helping it weather the worst of the turmoil.

¶7. (U) The economic slow-down, a decline in copper prices and an accompanying rise in unemployment top the list of Chilean economic concerns. Chile's GDP grew by a less than the expected 3.2 percent in 2008. The economy may grow at a rate of less than 1 percent in 2009, according to some forecasts. Copper accounted for more than 59 percent of Chile's exports in 2008, and its price is currently around 50 percent off of highs seen in mid 2008. The national unemployment rate is currently 8.5percent, although by some measures it has already climbed into double digits in several regions, including Santiago. As economies around the world contract, demand for Chilean exports is decreasing. The global crisis has also affected liquidity in the financial sector, making it harder for some companies to maintain access to capital.

¶8. (U) Despite these concerns, Chile has maintained a budget surplus, relatively low debt, and more than USD 21 billion in offshore sovereign wealth funds, mostly from record copper prices in previous years. Poverty dropped from 40 percent of the national population in 1990 to 14 percent in recent years. In January 2009, President Bachelet announced a USD 4 billion plus (2.8 percent of GDP) stimulus plan to help boost economic growth and maintain employment. According to a study compiled by the Treasury Department, Chile's plan is the fifth largest in the world based on the size of the investment relative to GDP. In March, the Chilean government announced a Pro-Credit Initiative to further stimulate the domestic economy by helping generate USD 3.6 billion in private loans.

#### Chile: A Leader in Trade

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¶9. (U) Chile has been a global leader in trade liberalization for the past 20 years and can boast trade agreements with 58 countries. New FTA agreements with Peru and Australia came into effect in March 2009, and Chile is currently negotiating FTA's with Russia, Malaysia and Turkey. Chile is also a member of the P-4 (Trans-Pacific Partnership Agreement).

¶10. (U) The U.S. is Chile's largest trading partner, and Chile is our fifth largest trading partner in Latin America. Overall bilateral trade has grown by more than 200 percent since the U.S.-Chile FTA was signed in 2004, reaching USD 20 billion in 2008. The U.S.-Chile FTA continues to benefit both nations. Chile is in the process of allowing U.S. beef to enter its market. However, sticking points remain. Chile is on the Special 301 Priority Watch list for its poor performance in protecting intellectual property, including copyrights, trademarks, pharmaceutical patents, and proprietary clinical test data for pharmaceuticals and agricultural chemicals. In October 2008, the Chilean Congress took a positive step by passing the Patent Cooperation Treaty. However, Chile still has a long way to go in improving its IPR protections, including approving a draft copyright law (now before Congress) and strengthening enforcement mechanisms to fight trademark counterfeiting and copyright piracy.

#### The U.S. and Chile: Partners Across the Board

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¶11. (U) The U.S. and Chile continue to partner on a broad set of initiatives, including education, scientific research, and military-military cooperation. In May 2008, President Bachelet announced government plans to significantly increase scholarships for Chileans to study abroad. The new GOC scholarship program is currently being launched with plans to send over 2,500 students/scholars overseas in 2009. Program leaders estimate that approximately one-third may choose to study in the U.S. These exchanges build on the success of the U.S.-Chile Equal Opportunities Scholarship Program, inaugurated in 2007, to sponsor English and academic studies for Chilean PhD students who come from disadvantaged and rural areas that have not traditionally had access to English language schools or study abroad opportunities.

¶12. (U) The Chile-California Partnership for the 21st Century is an umbrella agreement signed on June 12, 2008, by President Bachelet and Governor Arnold Schwarzenegger. It is a revival of a pair of previously existing cooperation projects from the 1960's: The Chile-California Program (1963-1970) and the University of Chile-University of California Cooperation Program (1965-1970). In signing the agreement, Chile and California have agreed to coordinate efforts and promote collaboration through cooperative actions and initiatives in sectors including education, the environment, technology, agriculture and energy. During a 2008 meeting with President Bachelet in California, Governor Schwarzenegger signaled his interest in visiting Chile -- a move that would delight Chileans.

¶13. (SBU) The U.S. and Chile also enjoy a strong military-military relationship. The capability and professionalism of the Chilean Armed Forces, along with our continuing, positive bilateral engagement, make Chile an ideal training partner, especially when compared with the other militaries in the region. There are regular exchanges between the U.S. and Chilean military to include operational forces, academy students, technical experts, as well as reciprocal visits between military leaders from both countries. Chile actively participates in joint exercises and is pursuing a military modernization program that will rely heavily on U.S. equipment, thus increasing interoperability. Already Chile boasts the largest Foreign Military Sales Program in SOUTHCOM, and more purchases are pending. A State Partnership Program, which links a U.S. State National Guard with the Chilean Armed Forces, was inaugurated on April 29 with the state of Texas by the National Guard Bureau and the SOUTHCOM Commander. This program will further strengthen military ties and open new avenues for military to military cooperation.

#### Facing a Serious Energy Crisis

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¶14. (SBU) Chile is facing a series of energy and environmental

policy challenges, including how to supply the projected 12,000 MW it needs over the next ten years. Recent droughts, predicted changes to hydrological cycles as a result of climate change, and reduced natural gas supply from Argentina have forced Chile to increase dependence on diesel and coal, and look to liquid natural gas to supply its energy demand. Uncertainty about securing energy supplies is a top concern of Chile's government because of its potential impact on the country's economic growth. Chile's electricity matrix is dominated by hydropower and thermal plants, with coal's usage likely to increase over the next ten years. The country has very little domestic hydrocarbons and is highly dependent on imports. In 2007 Argentina cut Chile's gas supply to barely meeting residential demand, and drought reduced hydroelectric to the point where Chile launched an aggressive energy conservation campaign to stave off rolling blackouts.

¶15. (SBU) Continuing supply disruptions have led Chile to pursue alternatives for importing natural gas and to acknowledge the need to reduce energy consumption, increase energy efficiency and explore the full range of energy sources, including renewables and nuclear. The situation is complicated by the fact that although Chile has a Minister of Energy, Marcelo Tokman, responsibility for energy policy is not consolidated under a single ministry, but distributed among a number of government agencies. The law creating a Minister of Energy, which would be responsible for long-term energy policy, will likely be passed in mid-2009. Moreover, although President Bachelet promised not to introduce nuclear power during her administration, a national debate over nuclear generated power is underway. The National Energy Commission has commissioned several studies to explore the issues, and both major presidential candidates have indicated a willingness to explore energy options.

¶16. (SBU) Chile is eager to expend cooperation with the U.S. on a range of energy and environment issues, particularly on renewables and energy efficiency, and to exchange information on policies, technology and commercially viable options for improving its energy situation. Chile is working with several U.S. agencies to increase bilateral cooperation in three target projects: launching its New Renewable Energy Center; an international bid solicitation for a pilot solar plant in northern Chile; and energy policy formation, including energy efficiency policies.

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